Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Rate Regulation	)	

REPLY COMMENTS OF LIBERTY MEDIA CORPORATION

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SUMMARY

Cable operators, as the retailers of programming to the ultimate consumer, must have an opportunity to recoup their costs and earn a reasonable profit on the sale of programming. Otherwise, arbitrary regulatory disincentives will replace the marketplace in determining the programming choices available to viewers, and the quantity, quality and diversity of programming will be adversely affected.

Although the other Commission alternatives are preferable to its "second" approach, both of those alternatives also must be modified to promote the addition of services on regulated tiers and to decrease discrimination against higher-cost services. In spite of the problems inherent in each alternative, Liberty Media believes that elements of the two proposals offer a reasonable rate adjustment mechanism.

The first alternative offers the benefit of administrative simplicity and decreases the adverse impact of further declining benchmark rates by decreasing their application to the additional channels. Thus, to the extent that this alternative provides for recovery of direct programming and other costs, including equipment, installation, administration, and promotional costs, along with a reasonable profit, it minimizes the arbitrary benchmark disincentives to adding programming services. However, because higher-cost programming exceeds the permissible benchmark rate, rigid application of the Commission's first alternative would skew future carriage decisions against higher-cost programming services. For such services,

cable operators could not recover the costs of adding the programming, much less any profit.

The Commission's third and preferred alternative offers a "safety net" for higher-cost programming by permitting full recovery of the additional programming costs associated with new channels. Consequently, this alternative reduces, to some extent, the incentive to carry higher-cost programming services exclusively on an a-la-carte basis. However, this alternative also fails to provide adequate incentives to add programming because it reduces the cable operator's existing profit margin and penalizes cable operators with lower-than-benchmark rates and/or higher-cost programming services.

Liberty Media's proposal to combine elements of the Commission's first and third alternatives fosters the policy objectives of the Commission and Congress while maximizing administrative simplicity. The adjustment methodology ultimately adopted by the Commission must permit cable operators to recover the full cost of additional programming services, including equipment and related charges, plus a reasonable profit.

Finally, the Commission should clarify its adjustment methodology to make clear that: (1) the tier-neutral benchmarks apply only to the additional channels or to the changed tier(s); (2) rate adjustments for programming additions or deletions on the basic tier do not trigger franchise authority review of a rate increase; and (3) the rate adjustment methodology will not provide an excuse for seeking proprietary cost information or authorize widespread disclosure of such information.

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Liberty Media Corporation ("Liberty Media") submits these reply comments in response to selected comments addressing the appropriate "methodology" for adjusting cable rates when programming services are added to or deleted from regulated service tiers. The comments in this proceeding confirm that such "methodology" should combine elements of the first and third alternatives identified in the Third Notice of Proposed Rulemaking, FCC 93-428, released August 27, 1993 ("Third Notice"), to ensure that the Commission's rate regulations do not preclude the addition of programming services to regulated tiers or discriminate against higher-cost programming services.

Preliminary Statement

The comments make clear that the Commission's rate adjustment mechanism will have a direct and substantial effect on the quantity, quality and diversity of programming available to cable subscribers. Commenters with programming interests uniformly recognize that cable operators, as the retailers of programming to the ultimate consumer, must have an opportunity to recoup their costs and earn a reasonable profit on the sale of programming. Otherwise, arbitrary regulatory disincentives will replace the marketplace in determining the programming choices available to viewers. Regulations which do not permit recovery of the costs of additional programming and a reasonable profit will discourage the addition of new programming to regulated service tiers and the creation of new tiers, contrary to policy objectives of the Commission and Congress.

The comments submitted in this proceeding confirm that programmers already face increased difficulty in expanding the carriage of programming services on regulated tiers as a result of the regulatory uncertainty and apparent disincentives to adding programming under the benchmarks. Programmers also are facing increased pressure from cable operators to shift existing programming services from regulated tiers to a-la-carte offerings.[1] Thus, the adverse effects of benchmark

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[1] See Comments of the Hearst Corporation ("Hearst") at 2 (benchmark rate regulation has created "a difficult environment for on-going contract renewal negotiations" because "many cable operators feel compelled to utilize a la carte offerings as the only remaining approach with any modicum of certainty"); Comments of The Disney Channel ("Disney") at 5 (while more than 200 cable systems shifted Disney from an

rate regulation on programmers which Liberty Media anticipated in its Petition for Reconsideration in this proceeding are appearing in the marketplace. See Liberty Media Petition for Reconsideration, filed June 21, 1993, at 18-21.

In order to promote the addition of new programming services and to preserve and enhance the diversity of programming available to cable subscribers, the appropriate rate adjustment mechanism must eliminate the financial disincentive for cable operators to add programming services to regulated tiers. Further, although the incentives in benchmark rate regulation for cable operators "to position higher cost programming on unregulated a la carte tiers...probably cannot be engineered out of the rules entirely," this effect "can be moderated" through adoption of an appropriate rate adjustment mechanism. Comments of National Broadcasting Company, Inc. ("NBC") at 4.

I. By Combining Its First And Third Alternatives, The Commission Can Reduce The Disincentives To Adding New Programming And To Discriminate Against Higher-Cost Services.

In the Third Notice, the Commission sought comment on three alternative "methodologies" for adjusting rates to account for the addition or deletion of programming services

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a-la-carte offering to a program tier in the 12 months preceding adoption of the First Report and Order, MM Docket No. 92-266, FCC 93-177, released May 3, 1993, not one system has added Disney to a regulated tier since that Order was adopted); see also Multichannel News, Sept. 13, 1993, at 1.

on regulated tiers. The comments in this proceeding strongly support the Commission's tentative conclusion to reject its second alternative and suggest that combining its other proposals will further the public interest objectives identified in the Third Notice, preserve the diversity of programming available to cable subscribers, and promote the continuation and expansion of local program origination.[2]

A. The Commission Should Not Sacrifice Program Diversity For The Sake Of Administrative Convenience.

With a single exception, commenters uniformly support the Commission's tentative conclusion to reject the second alternative identified in the Third Notice. Under that approach, the new regulated rate for a modified service tier would be determined by multiplying the new per-channel benchmark (based on the new total number of channels on the system) by the number of channels on the modified tier. Third Notice at ¶138. Although simple to administer, the Commission tentatively decided to reject this alternative because it would

[2] The Commission stated that the appropriate rate adjustment methodology "should provide sufficient incentives for cable operators to invest in continued growth of cable television service while not permitting operators to raise rates to unreasonable levels." Third Notice at ¶136. Liberty Media has suggested that, because the rate adjustment mechanism will directly affect the quantity and quality of programming added to regulated service tiers, diversity and local program origination -- important policy objectives identified by Congress in the Cable Television Consumer Protection and Competition Act of 1992 -- also should guide the Commission's choice of methodologies. Liberty Media Comments at 2-3.

"create substantial disincentives for cable operators with rates above the benchmark to add channels" and simultaneously create "undue incentives for systems with below benchmark rates to add channels." Id.

The record clearly confirms that this alternative would adversely affect the quality and diversity of programming available to consumers by arbitrarily limiting the programming services which cable operators could economically add to regulated tiers. See, e.g., Comments of Discovery Communications, Inc. ("Discovery") at 7 (second alternative would "create a powerful disincentive to add channels"); Comments of Viacom International Inc. at 7 (second alternative would require operator "either to forgo adding programming altogether or to offer new (or existing, but relatively expensive) program services on an unregulated, a la carte basis only") (emphasis in original); Comments of Affiliated Regional Communications, Ltd. ("ARC") at 4 (second alternative "affirmatively discourage[s] carriage of higher-cost programming services").

Only the National Association of Telecommunications Officers and Advisors/National League of Cities ("NATOA/NLC") favors this approach because it "should be easier for franchising authorities and the Commission to administer and is consistent with the benchmark methodology." See NATOA/NLC Comments at 15-16. Although administrative simplicity offers a legitimate benefit (see Liberty Media Comments at 4), it does not outweigh the more significant public interest objectives identified by the Commission and Congress. Because there is no dispute that this methodology would discourage the development and distribution of new programming on regulated tiers, there is compelling support for the Commission's tentative conclusion to reject it.

B. Combining Elements Of The First And Third Alternatives Will Promote The Addition Of New Services And Reduce Discrimination Against Higher-Cost Services.

Although the other Commission alternatives are preferable to its "second" approach, both of those alternatives also must be modified to promote the addition of services on regulated tiers and to diminish discrimination against higher-cost services. In spite of the problems identified by Liberty Media and other commenters with each alternative, Liberty Media believes that elements of the two proposals offer a reasonable rate adjustment mechanism.

Under the Commission's "first" proposal, the new regulated rate for the modified tier would be the existing rate plus the new per-channel rate (based on the new total number of channels on the system) times the number of new channels on the tier. Third Notice at ¶137. Those commenters supporting the first alternative identified by the Commission focus on the benefit of administrative simplicity. Comments of Time Warner Entertainment Company, L.P. ("Time Warner") at 2-3. In many cases, this methodology would create a strong incentive to add new programming because, "in addition to offsetting programming costs, it provides operators a source of revenue under the benchmark system to offset the capital improvement costs incurred in expanding system capacity." Discovery Comments at 6.

Although the Commission has expressed concern that this methodology might "permit tier pricing above economies of scale observed in the industry survey and reflected in the benchmark" (Third Notice at ¶137), commenters have identified significant costs, in addition to program acquisition costs, which cable operators incur to provide additional programming services over existing system capacity. See, e.g., Comments of Community Antenna Television Association, Inc. ("CATA") at 3 (equipment and other expenses may result in cost of $5,000); Comments of Medium Sized Operators Group at 4 (equipment and installation costs of approximately $5,000 and the "advertising and administrative costs of marketing new programming services"). Thus, to the extent that the Commission's first alternative provides for recovery of direct programming and other costs, including equipment, installation, administration and promotional costs, along with a reasonable profit, it minimizes the arbitrary benchmark disincentives to adding programming services.

Rigid application of the Commission's first alternative, however, would skew future carriage decisions against higher-cost programming services because cable operators could not recover the costs of adding the programming, much less any profit. See, e.g., Disney Comments at 2 (Disney license fee "will virtually always exceed a cable system's per channel benchmark"); ARC Comments at 4 (cost of regional sports services to cable operators may exceed applicable per-channel benchmark); NBC Comments at 2.[3] Consequently, the Commission's adjustment methodology must permit cable operators to recover the full cost of adding services even though such cost may exceed the benchmark.

The Commission's third and preferred alternative offers a "safety net" for higher-cost programming by permitting full recovery of the additional programming costs associated with new channels. Consequently, this alternative reduces, to some extent, the incentive to carry higher-cost programming services exclusively on an a-la-carte basis. See, e.g., Disney Comments at 3-4; NBC Comments at 2 n.3; ARC Comments at 6.

[3] See also Supplemental Comments of the Medium-Sized Operators Group on Petitions for Reconsideration, filed in MM Docket No. 92-266 on Aug. 4, 1993, at Exhibit 1 (The rates for cable programming services typically carried on a tier range to $1 for regional programming services and to 78¢ for national programming services.).

Nonetheless, commenters also have identified significant shortcomings in the third alternative. In addition to its increased complexity (Comments of Tele-Communications, Inc. at 2-3), several commenters note that this approach, as proposed by the Commission, would not provide adequate incentives to add programming because it reduces the cable operator's existing profit margin. Hearst Comments at 8-10; Liberty Media Comments at 9-10; NBC Comments at 4; Comments of New York State Commission on Cable Television ("NYSCCT") at 2-3; Time Warner Comments at 3-4. Other commenters claim that this methodology would penalize cable operators who have historically charged lower-than-benchmark rates and/or provided higher-quality programming services and, therefore, incurred higher per-channel program costs. Comments of Newhouse Broadcasting Corporation at 3; CATA Comments at 2-3. Proposed modifications include eliminating the efficiency factor; limiting the efficiency adjustment to the additional channels; and revising the proposed formula to exempt not only existing programming costs, but also a reasonable profit on such programming from the efficiency adjustment. See Disney Comments at 7; Comments of Joint Parties at 5-6, 10; Liberty Media Comments at 9-11 (elimination of "efficiency factor").

Liberty Media respectfully submits that its proposal to combine elements of the Commission's first and third alternatives fosters the policy objectives of the Commission and Congress while maximizing administrative simplicity. See also Discovery Comments at 6-8. The adjustment methodology ultimately adopted by the Commission must permit cable operators to recover the full cost of additional programming services, including equipment and related charges, plus a reasonable profit.

II. The Commission Should Clarify The Adjustment "Methodology" And Its Implementation.

The comments in this proceeding reflect varied interpretations of the adjustment methodologies identified by the Commission. To promote uniform interpretation and implementation of its rate adjustment methodology, additional clarification is required.

First, the Commission should confirm in its final rate adjustment methodology that the adjustment will apply only to the regulated tier(s) on which programming has been added or deleted. Although each of the Commission's proposals applies the tier-neutral benchmarks only to the additional channels (first approach at ¶137) or to the changed tier (second and third approaches at ¶¶138, 143), the comments reflect considerable confusion over this issue, particularly in applying the Commission's preferred alternative. See, e.g., CATA Comments at 2; Hearst Comments at 5; Comments of Falcon Cable, et al. ("Falcon Cable") at 8 (preferred alternative might apply revised per-channel benchmark to all channels on all regulated tiers). Application of the revised benchmarks to all regulated channels would have serious unintended consequences. See, e.g., Comments of the National Cable Television Association, Inc. ("NCTA") at 6-7. Among other things, such approach would result in changed rates for basic service when a programming service is added to or deleted from another regulated tier. See Liberty Media Comments at 4.

Second, the Commission should clarify that rate adjustments for programming additions or deletions on the basic tier do not trigger franchise authority review of a rate increase under Section 76.933(b) of the Commission's Rules. Without such clarification, franchising authorities could seek to delay carriage of new services for months. See Falcon Cable Comments at 8-9; Hearst Comments at 12; NCTA Comments at 10-11; NYSCCT Comments at 3. Further, local franchising authorities should be prohibited "from engaging in costly and intrusive fishing expeditions into the highly sensitive area of program contracts." NCTA Comments at 10 n.15; see Time Warner Comments at 5-6. Straightforward declarations attesting to the accuracy of a cable system's programming cost calculations should be sufficient. Id.

Finally, the Commission should reject the attempts of local franchising authorities to complicate further an already complex rate regulation process. For example, Austin, Texas, <u>et al.</u> have proposed yet another layer of complexity -- the Commission would collect "programming cost information on a multiple system operator (MSO) basis...then make this information available to local franchising authorities that request the information, although the primary authority to interpret and apply the information for the basic tier should reside with the franchising authority." Comments of Austin, Texas, <u>Et Al.</u>, Exhibit A at 1. The Commission has recognized that the terms and conditions of contracts between cable operators and programmers are proprietary and should be accorded confidential treatment. <u>See</u> 47 C.F.R. §76.1003(h), (i). The simultaneous "interpretation and application" of programming cost information by thousands of franchising authorities would unnecessarily complicate and delay negotiations between cable operators and programmers and would ultimately inject local governments into those negotiations, raising serious First Amendment concerns.

<u>Conclusion</u>

Congress expressly recognized that cable operators are entitled to earn "a reasonable profit" and directed the Commission to consider that factor in prescribing cable rate regulations. 47 U.S.C. §543(b)(2)(C)(vii). Liberty Media respectfully submits that an adjustment methodology which combines elements of the first and third alternatives will: (1) provide cable operators with an opportunity to recover their programming expenditures and to earn a reasonable profit on additional programming services; and (2) foster not only the policy objectives of the Commission in this proceeding, but also the recognized public interest in diversity of programming choices and locally originated programming.

October 7, 1993

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